

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

KRYSTAL PAPCKE,

Debtor.

Case No. 99-24700

Chapter 7

BRUCE LANSER, TRUSTEE,

Plaintiff,

v.

Adversary Proceeding No. 99-2381

RUSSELL PAPCKE,

Defendant.

MEMORANDUM DECISION ON
TRUSTEE'S MOTION FOR SUMMARY JUDGMENT

INTRODUCTION

This action was brought by the chapter 7 trustee, alleging that a payment to the defendant, pursuant to a family court order, was a preferential payment under 11 U.S.C. § 547. The defendant is the debtor's father. After the defendant answered the complaint and propounded affirmative defenses, the trustee moved for summary judgment. For the reasons stated below, the trustee's motion is granted.

This court has jurisdiction under 28 U.S.C. § 1334, and this is a core proceeding under 28 U.S.C. § 157(b)(2)(F). This decision constitutes the court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052.

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FACTS

The relevant facts are as follows. The debtor, Krystal Papcke, formerly known as Krystal Downs, filed for divorce from her husband, Paul Downs, on August 18, 1997. While the divorce was pending, Mr. Downs became aware that a worker's compensation award was forthcoming to Ms. Papcke. Concerned that the funds might be dissipated if they were paid to Ms. Papcke before the court divided the couple's property, Mr. Downs demanded that those funds be included in the marital estate. He filed a motion to modify the temporary order to bring those funds within the court's jurisdiction. The court ordered Ms. Papcke's attorney to deposit the worker's compensation proceeds into his trust account until further direction of the court.

Before trial, the parties entered into a partial settlement agreement resolving a number of issues unrelated to the transaction which is the subject of this action. Then, at the time of trial, the parties entered into an oral agreement, which the court incorporated into its Findings of Fact, Conclusions of Law and Judgment of Divorce, dated January 6, 1999. (Judgment ¶ 11j.-1.). Apparently, as a means to balance out the assets and debts of the marital estate, the parties agreed that Mr. Papcke receive the entire amount of the funds held by Ms. Papcke's attorney, which totaled \$9,542. The sum was awarded to Mr. Papcke to obtain a release of a lien on a Pontiac Bonneville awarded to Mr. Downs. Ms. Papcke agreed to hold Mr. Downs harmless on the debt due her father for the purchase of the car, which the divorce decree states was in the original amount of \$5,000. The funds were disbursed to Mr. Papcke directly from the trust account of Ms. Papcke's attorney on January 7, 1999. Ms. Papcke filed a petition for chapter 7 relief on May10, 1999.

Mr. Downs' financial statement dated September 25, 1998, which was filed in his and the debtor's divorce proceeding, lists R. Papcke as the lienholder on the Bonneville, with a \$5,000 lien. He states that the car had a NADA value of \$3,125 as of September 1997, and Krystal Downs' financial disclosure statement dated August 19, 1996, estimated the value at \$2,500. The financial statement of Paul Downs also lists Russell Papcke as a creditor for a cycle with an unknown value, and Krystal Downs' statement shows a "Harley" as having a value of \$14,500 with a remaining debt of \$6,222.24.¹ The debtor's bankruptcy schedules do not list any debt owed to Mr. Papcke. Mr. Papcke's affidavit filed in this adversary proceeding asserts that he loaned the couple approximately \$40,000 during the marriage.

ARGUMENTS

The trustee contends that the debtor's attorney, on behalf of the debtor, agreed on the record before the family court that out of his trust account he would pay Mr. Papcke the debtor's proceeds from a worker's compensation injury. The transfer was of an interest in property of the debtor, and made to the debtor's father, an insider, within one year prior to the filing of the chapter 7 petition, on account of an antecedent debt. The transfer was made when the debtor was insolvent, and it enabled the defendant to receive more money than he would have received if the transfer had not been made and if the defendant had received a dividend under a chapter 7 distribution.

Mr. Papcke asserts that summary judgment is not appropriate because he disputes whether the transfer by the debtor was voluntary and whether the defendant knew or had reason

¹The record does not reveal who was awarded the Harley.

to know that the debtor was insolvent at the time of the transfer.² He argues that the funds were not property of the debtor as they were never in the control of the debtor. He further asserts that the worker's compensation proceeds are exempt as to the debtor and would not be distributable to creditors because she could recover the proceeds from the trustee pursuant to 11 U.S.C § 522(g).³

DISCUSSION

The elements of a voidable preference are set forth in § 547(b) of the Code:

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property --

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made --
 - (A) on or within 90 days before the date of the filing of the petition; or
 - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
- (5) that enables such creditor to receive more than such creditor would receive if -

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²The 1994 amendments to 11 U.S.C. § 547 did away with the requirement that the defendant not know or have reason to know of the debtor's insolvency, and this defense need not be addressed.

³Section 522(g) provides as follows:

(g) Notwithstanding sections 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if --

- (1) (A) such transfer was not a voluntary transfer of such property by the debtor; and
 - (B) the debtor did not conceal such property; or
- (2) the debtor could have avoided such transfer under subsection (f)(2) of this section.

11 U.S.C. § 522(g).

- (A) the case were a case under chapter 7 of this title;
- (B) the transfer had not been made; and
- (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). Various defenses are found in 11 U.S.C. § 547(c). The trustee has the burden of proving the avoidability of a transfer under subsection (b), and the creditor has the burden of proving any defenses. 11 U.S.C. § 547(g).

The only element of 11 U.S.C. § 547(b) that is disputed by Mr. Papcke in his answer, his memorandum in opposition to the trustee's motion for summary judgment, or in his affidavits or exhibits is whether the funds transferred constituted "an interest of the debtor in property." He reasons that because the worker's compensation award was not available to his daughter, she did not have an interest in the property transferred. This argument is unavailing. The fact that the funds were deposited in her attorney's trust account, and she had no control over them, did not mean they were not her property. No one else had a beneficial interest in these proceeds. They were awarded to her because of her injury. They were subjected to property division in her divorce as they were part of her marital estate. They were used to pay a debt for which she was liable. The fact that she was not allowed to spend this money pending the outcome of her divorce did not make the funds any less hers. Thus, an interest in her property was transferred when Mr. Papcke was paid.

All submissions by both parties support all the other elements of 11 U.S.C. § 547(b), so the next inquiry is whether any of the defenses of 11 U.S.C. § 547(c) apply. Mr. Papcke's remaining defenses rest on his assertions that the payment to him was involuntary, and worker's compensation proceeds are exempt. If funds are exempt, they are not available for distribution

by the trustee. Furthermore, the debt owed to Mr. Papcke was not solely the debt of the debtor, but rather a joint debt of the marital estate. Mr. Papcke asserts that he gave contemporaneous consideration for funds released to him because they resulted in the release of the lien of a vehicle awarded to the debtor's former spouse, as well as other collateral that is not identified. The release also resulted in the debtor agreeing to hold her former husband harmless as to debts owed to her father. This benefit to the debtor's former spouse constituted contemporaneous consideration for the debtor. This court finds all of these defenses inadequate as a matter of law.

Section 547(c)(1) states that a transfer that is intended to be and actually is a contemporaneous exchange for new value received by the debtor cannot be recovered by the trustee. The new value in this case was release of the lien on a car awarded the debtor's spouse, worth considerably less than the amount of the transfer, plus the release of other unspecified property. As the defendant cannot identify other liens, the court is satisfied that payment in excess of the value of the car was payment of an unsecured debt.

Generally, the release of the lien on the car would constitute consideration to the debtor up to the value of the car. The value of the consideration could be no more than the creditor could have recovered for its security, i.e., the value of the collateral. Furthermore, had the exchange not taken place and the bankruptcy filed, the creditor in a chapter 7 case would have received at least the value of its security. *See* 11 U.S.C. § 547(b)(5)(A).

The problem with the defendant's argument in this case is that the consideration given by the defendant at the time of the transfer, i.e., release of a lien on a car valued at \$2,500 to \$3,125, passed to the debtor's former husband, not to the debtor, as is required to support a defense under 11 U.S.C. § 547(c)(1). Similarly, in *Grassmueck v. Food Indus. Credit Union*, 127 B.R. 869

(Bankr. D. Or. 1991), the debtor, pursuant to a dissolution decree and within 90 days prior to his bankruptcy petition, made over \$4,000 in automobile loan payments for a car that had been awarded to his former wife. Because these payments satisfied the loan, the creditor released its lien. During the bankruptcy case, the trustee brought an action to avoid the payments as preferential and to recover them from the creditor. The court ruled in favor of the trustee, holding that while release of a lien ordinarily constituted new value that would protect payments to a secured creditor from avoidance, the fact that the debtor did not own the vehicle subject to the lien meant that the estate did not benefit from the release. Therefore, the new value exception did not apply. *Id.* at 874.

The *Grassmueck* case was decided prior to the effective date of § 547(c)(7), and the result would have been different if the obligation to pay the loan payments was determined to be in the nature of support. *See, e.g., In re Whaley*, 190 B.R. 818, 822 (Bankr. N.D. Miss. 1995) (payment of nondischargeable support debt not recoverable as preference). However, even the defendant acknowledges that the transfer was pursuant to a division of property and was not intended as support for the debtor's former husband.

The requirement that the lien release must be on the debtor's property for the payment to constitute a contemporaneous exchange is also consistent with the court's holding in *In re Pacileo*, 87 B.R. 380 (Bankr. W.D. Pa. 1988). In that case the debtor husband, pursuant to a marital agreement, made various payments to secured, unsecured and undersecured creditors within 90 days of commencing his bankruptcy case. After he filed the petition, the trustee brought suit to recover the allegedly preferential payments. The payments for unsecured indebtedness were deemed preferences and judgment was entered in favor of the trustee.

However, because the debtor's payments to the secured creditor were on a mortgage for which both the debtor and his former wife were obligated, the payments benefitted both the debtor's property and that of his former wife. Thus, only one-half of the payment to the secured creditor was avoidable as a preference. *Id.* at 384.

Whether the payment to the defendant could have been or may now be claimed exempt is not one of the defenses in 11 U.S.C. § 547(c). A transfer that could be claimed exempt by the debtor before filing does not mean that the funds are exempt in the hands of the creditor or former creditor. On the contrary, the fact that the debtor may be allowed an exemption in funds recovered by the trustee indicates an intention by Congress that even a transfer of exempt funds be brought back into the estate. *See* 11 U.S.C. § 522(g). Only the debtor can claim exemptions, and any exemption the debtor might have had in the funds cannot be claimed by her transferee. *See* 11 U.S.C. § 522(b); *In re Noblit*, 72 F.3d 757 (9th Cir. 1995) (transferees lacked standing to raise debtor's homestead exemption as defense to preference action).

Likewise, whether the transfer by the debtor to the defendant was voluntary is of no consequence in determining the trustee's right to avoid the transfer. Section 522(g) provides that the debtor can, under certain circumstances, claim as exempt property recovered by the trustee if the original transfer was not voluntary. However, the circumstances giving the debtor the right to claim the exemption do not give the defendant the right to resist disgorgement of the transfer to the trustee. If it did, 11 U.S.C. § 522(g) would be redundant.

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ORDER FOR JUDGMENT

For the reasons set forth in the court's memorandum decision entered on this date, IT IS ORDERED that the plaintiff shall recover \$9,542 from the defendant, plus costs.

Judgment shall be entered accordingly.

Dated at Milwaukee, Wisconsin, September 15, 2000.

BY THE COURT

_____/s/_____
Honorable Margaret Dee McGarity
United States Bankruptcy Court

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